MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2015/2016

BAC3654 – PROFESSIONAL ETHICS

(All sections / Groups)

1 MARCH 2016
9.00 a.m. – 12.00 p.m.
(3 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of **FIVE (5)** printed pages with **FOUR (4)** questions.
2. Attempt **ALL** questions. All questions carry equal marks and the distribution of marks for each question is given.
3. Please write all your answers in the booklet provided.

QUESTION ONE (25 marks)

Read the following case, and then answer the given questions.

To Resign or Serve?

The Prairieland Bank was a medium-sized, Midwestern financial institution. The management had a good reputation for backing successful deals, but the CEO (and significant shareholder) had recently moved to San Francisco to be "close to the big-bank center of activity". He commuted into the Prairieland head office for two or three days each week to oversee major deals. Lately the bank's profitability had decreased, and the management had begun to renegotiate many loans on which payments had fallen behind. By doing so, the bank was able to disclose to them as current, rather than non-performing, as the unpaid interest was simply added to the principal to arrive at the new principal amount. Discussions were also under way on changing some accounting policies to make them less conservative.

Ben Hunt, the audit partner on the Prairieland Bank account, was becoming concerned about the risk associated with giving an opinion on the fairness of the financial statements. During the early days of the audit, it became evident that the provision for doubtful loans was far too low, and he made an appointment to discuss the problem with the CEO and his vice president of finance. At the interview, Ben was told that the executives knew the provision was too low, but they didn't want to increase it because that would decrease their reported profits. Instead, they had approached a company that provided insurance to protect leased equipment, such as earth movers, against damage during the lease, and arranged for insurance against non-payment on the maturity of their loans. As a result, they said, any defaults on their loans would be made up from the insurance company, so they didn't see any point to increase the provision for loan losses for disclosing the insurance arrangement.

When he heard of this, Ben expressed concern to the Prairieland management, but they were adamant. Because Prairieland was such a large account, he sought the counsel of James London, the senior partner in his firm who was in charge of assessing such accounting treatments and the related risk to the auditing firm. James flew out to confer with Ben, and they decided that the best course of action was to visit the client and indicate their intent to resign, which they did. After dinner, James was waiting at the airport for his plane home. By coincidence, he met Jack Lane, who held responsibilities similar to his own at one of the competing firms. Jack was returning home as well and was in good spirits. On the flight, Jack let it slip that he had just picked up an old client of James's firm – the Prairieland Bank.

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Required:

a. Identify the potential stakeholders of the Prairieland Bank and explain their respective interest.

(10 marks)

b. Which decision was considered as a right decision: *(i)* James London's auditing firm should resign from the Prairieland Bank or *(ii)* James London's auditing firm should continue to serve the Prairieland Bank? Give your justifications on the chosen decision.

(10 marks)

c. Advice James London on what should he do after hearing the news from Jack Lane?

(5 marks)

Total: 25 marks

QUESTION TWO (25 marks)

Read the following case and analyses the given tables. Then, answer the following questions.

Ford Pinto

In order to meet strong competition from Volkswagen as well as other foreign domestic subcompacts, Lee Iacocca, then president of Ford Motor Co., decided to introduce a new vehicle by 1970, to be known as the Pinto. The overall objective was to produce a car at or below 2,000 pounds with a price tag of $2,000 or less. Although reproduction design and testing normally requires about 3.5 years and the arrangement of actual production somewhat longer, design was started in 1968 and production commenced in 1970.

The Pinto project was overseen by Robert Alexander, vice president of Car Engineering, and was approved by Ford's Product Planning Committee, consisting of Iacocca, Alexander, and Ford's group vice president of car engineering, Harold MacDonald. The engineers throughout Ford who worked on the project "signed off" to their immediate supervisors, who did likewise in turn to their superiors, and so on to Alexander and MacDonald and, finally, Iacocca.

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Table 1: Ford's Cost-Benefit Analysis

Benefits:		
SAVINGS	**UNIT COST, ($)**	**TOTAL, ($)**
180 burn deaths	200,000	36,000,000
180 serious burn injuries	67,000	12,060,000
2,100 burn vehicles	700	1,470,000
Total benefits		49,530,000
Costs:		
NUMBER OF UNITS		
11 million cars	11	121,000,000
1.5 million light trucks	11	16,500,000
Total costs		137,500,000

Table 2: Cost of a Death –

Study of the National Highway Traffic Safety Administration

COMPOENENT	1971 COSTS, ($)
Future productivity losses	
Direct	132,000
Indirect	41,300
Medical costs	
Hospital	700
Other	425
Property damage	1,500
Insurance administration	4,700
Legal and court	3,000
Employer losses	1,000
Victim's pain and suffering	10,000
Funeral	900
Assets (lost consumption)	5,000
Miscellaneous	200
Total per fatality	200,725

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Many reports were passed up the chain of command during the design and approval process, including several outlining the results of crash tests, and a proposal to remedy the tendency for the car to burst into flames when rear-ended at 21 miles per hour. The tendency was caused by the placement of the car's gas tank between the rear axle and the rear bumper such that a rear-end collision was likely to drive the gas tank forward to rupture on a flange and bolts on a rear axle housing for the differential. The ruptured tank would then spew gas into the passenger compartment to be ignited immediately by sparks or a hot exhaust.

The remedy available to Ford included mounting the gas tank above the rear axle, which would cut down on trunk space, or installing a rubber bladder in the gas tank. Ford experimented with the installation of rubber bladders but apparently decided they were not cost-effective. Later, as part of a successful lobby effort against government regulations for mandatory crash tests (crash tests were delayed eight years, until 1977), Ford's cost-benefit analysis came to light in a company study entitled 'Fatalities Associated with Crash Induced Fuel Leakage and Fires". As the details in Table 1, the costs of installing the rubber bladder vastly exceeded the benefits.

Ford took the $200,000 figure for the cost of a death from a study of the National Highway Traffic Safety Administration, which used the estimates as presented in Table 2.

Required:

a. Is the decision not to install the rubber bladder appropriate? Use the 5-Question Framework to support your analysis. **(12 marks)**

b. Explain what are the weaknesses that you can identify in Ford's cost-benefit analysis? **(8 marks)**

c. If Ford decided to give its Pinto customers the option to have the rubber bladder installed during production on certain cost, would you think it is an appropriate decision? **(5 marks)**

Total: 25 marks

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QUESTION THREE (25 marks)

"The *Malaysian Code on Corporate Governance 2012* (MCCG 2012) focuses on strengthening board structure and composition recognising the role of directors as active and responsible fiduciaries. They have a duty to be effective stewards and guardians of the company, not just in setting strategic direction and overseeing the conduct of business, but also in ensuring that the company conducts itself in compliance with laws and ethical values, and maintains an effective governance structure to ensure the appropriate management of risks and level of internal controls".

(Forward by Tan Sri Zarinah Anwar, Chairman of Securities Commission Malaysian in the Malaysian Code of Corporate Governance 2012)

Required:

a. Discuss the roles and responsibilities of the Board of Directors, as stipulated in the Malaysian Code of Corporate Governance 2012 (MCCG 2012). **(10 marks)**

b. Suggest how the maxims of directors independence can be strengthen in a particular company's board. **(6 marks)**

c. Explain the Committee of Sponsoring Organizations (COSO) Enterprise Risk Management integrated framework. **(9 marks)**

Total: 25 marks

QUESTION FOUR (25 marks)

The MIA by-Laws have been issued pursuant to Section 10(a) of the Accountants Act 1967. The latest version was issued by the Council of MIA in December 2010 and came into effect on 1 January 2011, thus it revoked and superseded the January 2007's version.

Required:

a. Discuss the fundamental principles that derive the MIA by-Laws? **(10 marks)**

b. Explain the threats that could compromise the professional accountants' fundamental principles? **(10 marks)**

c. Explain why professional accountants are interested on risk management. **(5 marks)**

Total: 25 marks
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